

STATE BOARD OF LAND COMMISSIONERS
August 19, 2008
Regular Agenda

SUBJECT

Approve distributions to endowment beneficiaries for fiscal year 2010 and transfers from Earnings Reserve to the Permanent Fund.

BACKGROUND

By statute, the Land Board is to determine the allocation of the Earnings Reserve Funds of the endowments – how much to distribute to beneficiaries, how much to transfer to the permanent fund, and how much to retain for future distributions.

If the Land Board approves fiscal year 2010 distributions this August, then beneficiaries can include them in their budgets due September 1, 2008.

RECOMMENDATION

The Endowment Fund Investment Board recommends that distributions be based on the Distribution Policy approved by the Land Board last month. As shown in the table on the next page, this results in an overall 7.6% increase in distributions for fiscal year 2010 compared to fiscal year 2009.

Also, the Endowment Fund Investment Board recommends that \$16.9 million of excess Earnings Reserves for four endowments shown on the next page be transferred to their Permanent Funds effective September 1, since these endowments have more than five years of distributions in their reserves. Further, it is recommended that these transfers not increase the Gain Benchmark of the funds, so as to increase the likelihood that these funds will reach the Gain Benchmark in the future.

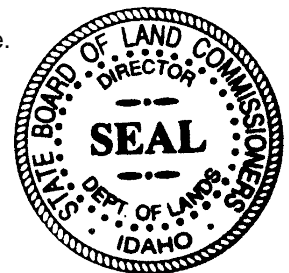
As explained in Attachment 1, the recommended distributions and transfers appear to be achievable and represent an appropriate balance between the interests of current and future beneficiaries, taking into account the current level of earnings reserves and past and expected fund revenues.

	<i>Distributions To Beneficiaries</i>				<i>Transfer To</i>
	<i>Approved</i>	<i>Proposed</i>			<i>Permanent</i>
	<u>FY2009</u>	<u>FY2010*</u>	<u>% Change</u>	<u>\$ Change</u>	<u>Fund**</u>
Public Schools	29,692,900	31,292,400	5.4%	1,599,500	-
Ag College	794,000	850,800	7.2%	56,800	200,000
Charitable Instit.	2,826,100	2,964,000	4.9%	137,900	-
Normal School	2,534,100	2,661,600	5.0%	127,500	-
Penitentiary	794,000	1,040,400	31.0%	246,400	1,500,000
School of Science	2,332,300	2,984,400	28.0%	652,100	-
State Hosp. South	1,258,700	1,532,400	21.7%	273,700	12,700,000
University	2,181,000	2,329,200	6.8%	148,200	2,500,000
	42,413,100	45,655,200	7.6%	3,242,100	16,900,000

* 5% of 3-year average permanent fund balance, adjusted for transfers from Earnings Reserve.

** Amount of Earnings Reserve in excess of five years of the fiscal year 2010 distribution.

All calculations subject to adjustment pending final audit of fiscal year 2008 results.



BOARD ACTION

A motion was made by Superintendent Luna to reduce the proposed University of Idaho \$2.5 million Permanent Fund distribution to \$1.9 million. Secretary of State Ysursa seconded the motion for discussion purposes. Superintendent Luna stated his intent is to have the option available to the Board but not to implement any solution at this time. Secretary of State Ysursa asked if the intent of the motion was to approve the entire presentation from the EFIB with the change of \$1.9 million on the transfer to the Permanent Fund instead of \$2.5 million. Superintendent Luna stated yes.

For clarification, Superintendent Luna brought forwarded an amended motion to approve the recommended distribution as outlined, with the exception that the moneys transferred to the Permanent Fund for the University of Idaho be reduced from \$2.5 million to \$1.9 million. With the stated clarification, Secretary of State Ysursa seconded the amended motion. The amended motion carried on a vote of 5-0.

For clarification, Mr. Johnson stated the amended motion covered the distribution and the transfer.

ATTACHMENT

1. Background on Proposed Fiscal Year 2010 Distributions and Transfers

Background on Proposed Fiscal Year 2010 Distributions and Transfers

***For the August 19, 2008
meeting of the Land Board
[DRAFT pending outcome of
August 11 EFIB meeting]***



Distributions: Decision Time

- As part of the budget process, the Land Board needs to approve endowment fund distributions for FY2010 at its August, 19 2008 meeting
 - The Endowment Fund Investment Board endorsed these proposed distributions and transfers at their August 11 meeting
- Approved amounts will be considered by the beneficiaries in submitting their full budgets to the Division of Financial Management September 1, 2008

Review of Distribution Policy

At its July 2008 meeting, the Land Board adopted the following principles:

- ▣ Distribute approximately 5% of the value of the Permanent Fund each year
- ▣ Maintain an Earnings Reserve balance equal to five years of distributions
- ▣ Transfer excess reserves back to the Permanent Fund each year

The Land Board can adjust these amounts

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Summary of Recommendations

(based on unaudited 6/30/08 balances)

- ▣ The 5% of the Permanent Fund formula results in a 7.6% average increase in distributions for FY2010 compared to FY2009
 - Two endowments were at a 4.1% for FY2009, but reserves are sufficient to move them back to 5%
- ▣ Four endowments have excess reserves:
 - \$17 million available to be transferred to their Permanent Funds
 - Transfers increase distributions by \$275,000
- ▣ Four endowments have less than the desired five years of reserves:
 - But, all have sufficient reserves to support the level of distributions called for by the 5% policy formula

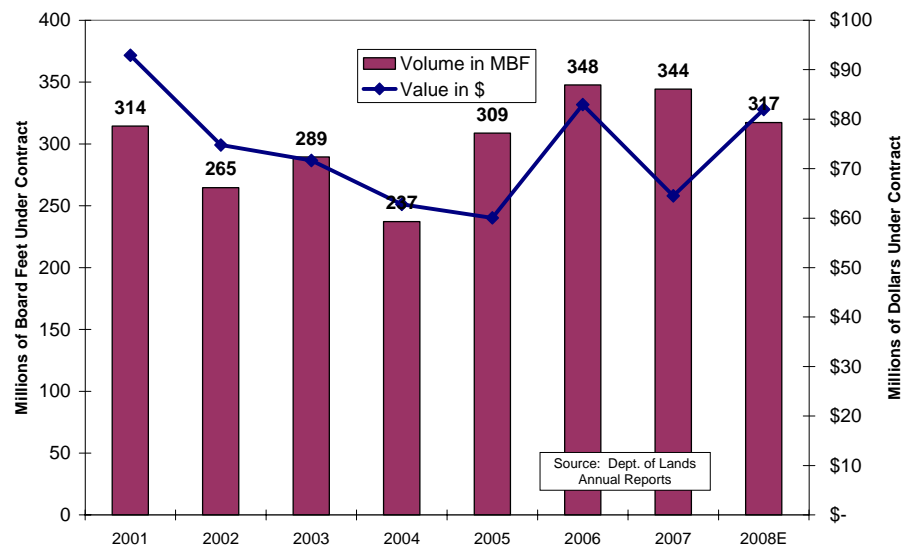
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Good News

- ▣ Strong revenues from Lands in fiscal 2008 result in net cash flow gain of \$50 million
- ▣ Earnings Reserves grow to a record level – \$190 million
 - 3.4 years to 15.4 years of distributions, depending on the endowment
- ▣ FY2009 approved distribution is safe – every fund has reserves in excess of 3.4 years
- ▣ Over \$80 million of timber was presold as of June, 2008
 - Guaranteed income over the next 3 years

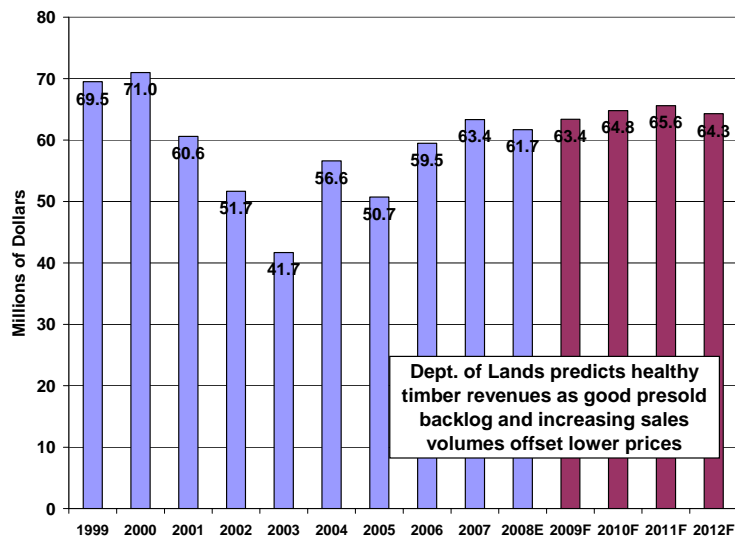
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Dept. of Lands -- Timber Under Contract at Fiscal Year End



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Timber Revenue Forecast



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Distributions/Transfers

Based on June 2008 unaudited balances

	(\$ in millions)								
	Total	Public School	Ag College	Charitable	Normal Schools	Penitentiary	School of Science	State Hospital South	University
EFIB staff recommendations: green lines									
Permanent Fund Value									
3-Year Average	907.5	625.8	16.9	59.3	53.2	20.3	59.7	26.4	45.7
Distribution % Per Policy	5.0%	5.0%	5.0%	5.0%	5.0%	5.0% (up from 4.1% last year)	5.0%	5.0%	5.0%
FY 2007 Distribution	35.8	24.6	0.7	2.4	2.1	0.8	2.4	1.1	1.8
FY 2008 Distribution	38.6	27.0	0.7	2.6	2.3	0.7	2.1	1.1	2.0
FY 2009 Distribution	42.4	29.7	0.8	2.8	2.5	0.8	2.3	1.3	2.2
2010 Distributions									
Before transfer to Permanent Fund	45.4	31.3	0.8	3.0	2.7	1.0	3.0	1.3	2.3
After transfer to Permanent Fund	45.7	31.3	0.9	3.0	2.7	1.0	3.0	1.5	2.3
% Change vs. 2009 Distribution									
After transfer to Permanent Fund	7.6%	5.4%	7.1%	4.9%	5.1%	31.0%	28.0%	21.7%	6.8%
Years of Reserve									
Adequate Years of Reserve (policy)	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0
Before transfer to Permanent Fund	4.2	3.4	5.3	4.1	4.9	6.6	4.7	15.4	6.2
After transfer to Permanent Fund	3.8	3.4	5.0	4.1	4.9	5.0	4.7	5.0	5.0
Earnings Reserve Balance (6/08)									
	190.9	105.8	4.5	12.3	13.0	6.7	14.1	20.4	14.2
Transfers to Permanent Fund									
	16.9	0	0.2	0	0	1.5	0	12.7	2.5
% of Earnings Reserve	9%		4%			22%		62%	18%

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Addressing endowments with less than five years of reserves

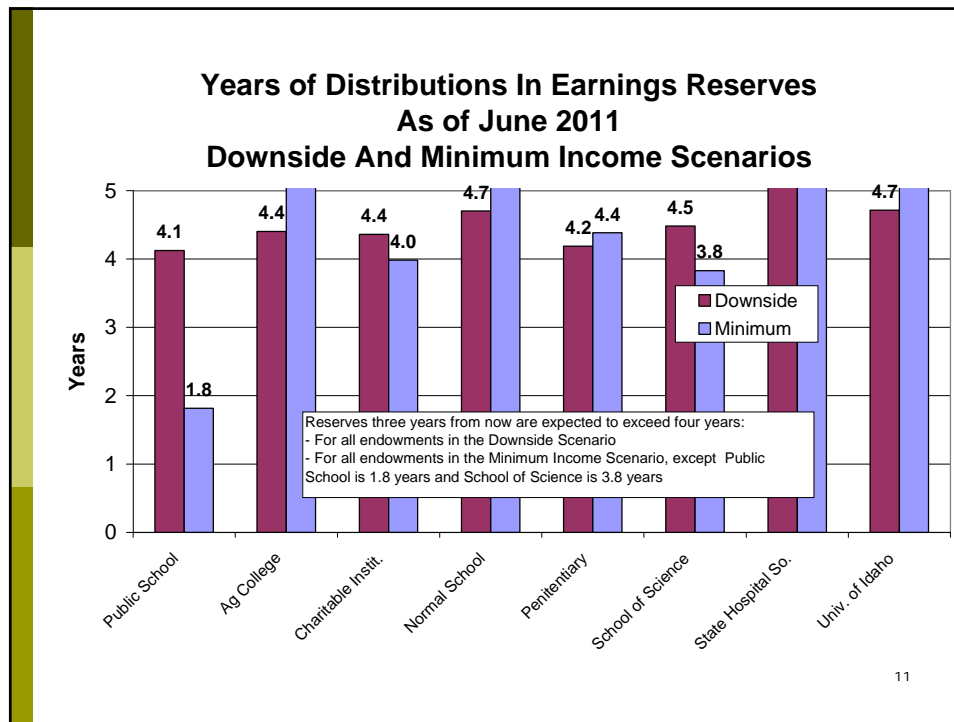
- The 5% formula calls for increases in distributions for four endowments that have less than five years of reserves
- Is this increase prudent? Are we at risk of a significant reduction in the near future (thru 2011) if we have:
 - A reasonable "downside" market?
 - A "worst case" market?

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Two scenarios developed to test the weaker endowments thru FY2011

- **Downside case:**
 - Relative to Lands' forecast, timber revenues decline by half their normal variance in 2009 and 2010 and by twice their normal variance in 2011
 - Reduces timber revenues by \$56 million or 29%
 - A reasonable "downside" scenario
- **Minimum income case:**
 - No timber income, except for existing uncut contracts
 - Lease revenues continue at current levels
 - A reasonable "worst case" scenario
- For both cases: Reserves reduced by transfers to the Permanent Fund, no capital gains income
- Forecasted years of reserves for the two scenarios as of 6/2011 are shown on the next page

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Conclusion

- ❑ Even though four endowments do not have five years of reserves, it is prudent to increase their distributions in FY2010
- ❑ A high level of presold timber at June 2008 and continued flow of interest and dividend income help ensure that no endowment exhausts its reserves by 2011 even in a "worst case", minimum income scenario

Gain Benchmark

- ❑ Per statute, when each endowment's Permanent Fund passes its Gain Benchmark (June 2000 level + inflation + deposits), then, two years later, total gain above inflation, rather than interest and dividends, begins flowing to Earnings Reserves
- ❑ The Land Board must designate whether a transfer increases the Gain Benchmark (becomes permanent corpus) or not
- ❑ Since no endowment is above its Benchmark yet, recommend that all transfers not increase the Benchmark

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Shortfall From Gain Benchmark At 6/08

	<u>\$MM</u>	<u>% of Perm. Fund</u>	<u>Proposed Transfer</u>	<u>Achieve GBM After Xfer?</u>
Ag College	(1.0)	-5.5%	0.2	No
State Hosp. South	(2.9)	-10.9%	12.7	Probably
Normal School	(6.2)	-11.5%		
Penitentiary	(2.4)	-11.8%	1.5	No
Public School	(80.5)	-12.7%		
School of Science	(8.7)	-14.5%		
Charitable Instit.	(8.7)	-14.6%		
University of Idaho	(7.1)	-15.5%	2.5	No
Total	(117.5)	-12.8%	16.9	

- As of June 2008, no endowment had crossed its Gain Benchmark
- State Hospital will likely achieve the Gain Benchmark in June 2009 if the transfer is made
- Recommendation: All transfers do not increase the Gain Benchmark

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